

Internal Revenue Service

Department of the Treasury

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199911049

Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:CORP:4 PLR-116429-98

Date:

December 16, 1998

Distributing 1 =

Distributing 2 =

Sub =

Business A =

Business B =

Business C =

Asset =

Individual =

199911049

PLR-116429-98

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a =
b =
c =
d =
e =
f =
g =

Dear

We respond to your August 17, 1998 request for rulings on certain federal income tax consequences of a proposed transaction.

Summary of Facts

Distributing 2 is the common parent of a consolidated group and has outstanding Class A Common Stock, Class B Common Stock (together, the "Distributing 2 Common Stock"), and one series of preference stock. Distributing 2 wholly owns Distributing 1 and Sub. Distributing 1 is indebted to Distributing 2 and Sub (the "Intercompany Debt"). Distributing 1 was created and capitalized through a series of transactions for which private letter rulings from the Internal Revenue Service were previously obtained (the "Prior Rulings").

Distributing 2 conducts Business A, and Distributing 1 conducts Business B and Business C. We have received financial information indicating that each of these businesses has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Business Purpose

Highly motivated, entrepreneurial executives are critical to the success of both Business B and Business C, and Distributing 1 has had difficulty hiring and retaining people with these qualifications. Many of the executives that recently have joined

Distributing 1 were hired with the understanding that they would or could become significant equity owners in their particular business. However, because Business A is much larger than Business B, and Business B is larger than Business C, equity interests in Distributing 2 would primarily reflect the results of businesses other than the employing business. Distributing 2 has therefore concluded, based on the advice of consultants and other information, that it must create separate, independent companies for Business B and Business C in order to provide these executives with the equity interests they now expect.

Proposed Transaction

To accomplish this separation, Distributing 2 proposes the following series of transactions:

- (i) Distributing 1 will transfer the Business C assets to a newly formed subsidiary ("Controlled 1") in exchange for Controlled 1 stock and the assumption by Controlled 1 of liabilities related to the transferred assets, including an appropriate part of the Intercompany Debt ("Contribution 1"). Controlled 1 will accomplish the assumption of Intercompany Debt indirectly by borrowing funds from a third party lender (the "Assumption Funds") and distributing the Assumption Funds to Distributing 1 for use by Distributing 1 in repaying part of the Intercompany Debt.
- (ii) Distributing 1 will borrow funds from a third party lender and use those funds, together with the Assumption Funds, to repay all of its debt to Sub and part of its debt to Distributing 2.
- (iii) Distributing 1 will distribute the Controlled 1 stock to Distributing 2 ("Distribution 1").
- (iv) Distributing 2 will transfer the Distributing 1 stock, the remaining Intercompany Debt, and the Asset to a newly formed corporation ("Controlled 2") in exchange for Controlled 2 stock and the assumption by Controlled 2 of liabilities related to the transferred assets ("Contribution 2").
- (v) Controlled 1 and Controlled 2 each will issue the first tranche of its stock to certain of its senior executives.
- (vi) Controlled 2 will issue new shares of its stock pro rata to the Distributing 2 shareholders on their Distributing 2 Common Stock, and the Controlled 2 shares held by Distributing 2 will be cancelled ("Distribution 2"). Controlled 1 will issue new shares of its stock pro rata to the Distributing 2 shareholders on their Distributing 2 Common Stock, and the Controlled 1 shares held by Distributing 2 will be cancelled ("Distribution

3"; together with Distribution 2, the "Distributions").

(vii) Distributing 2 will redeem the Distributing 2 Common Stock held by Business B or Business C employees (except Individual).

(viii) Within a months of the of the Distributions, the b most senior executives of each new company will have purchased stock in their company representing in the aggregate a greater than c percent interest. Within d months, this interest will rise to greater than e percent. The total cost to the Controlled 2 executives for their Controlled 2 stock will be approximately f dollars. The total cost to the Controlled 1 executives for their Controlled 1 stock will be approximately g dollars.

Contribution 1 and Distribution 1 Representations

Distributing 1 makes the following representations concerning Contribution 1 and Distribution 1:

(a) No part of the consideration to be distributed by Distributing 1 will be received by Distributing 2 as a creditor, employee, or in any capacity other than that of a Distributing 1 shareholder.

(b) Following Distribution 1, Distributing 1 and Controlled 1 each will continue the active conduct of its business, independently and with its separate employees.

(c) The total adjusted basis and fair market value of the assets transferred by Distributing 1 to Controlled 1 will, in each instance, equal or exceed the sum of (i) the liabilities assumed by Controlled 1, (ii) any liabilities to which the transferred assets are subject, and (iii) the fair market value of any other property (including money) distributed to Distributing 2 under the plan of reorganization or to Distributing 1 creditors in connection with the reorganization.

(d) The liabilities assumed by Controlled 1 in the transaction and any liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.

(e) Distribution 1 is being carried out as part of a plan to allow Business C key employees to acquire a significant direct equity interest in Controlled 1. Distribution 1 is motivated in whole or substantial part by this corporate business purpose.

(f) Except for indebtedness that may arise in the ordinary course of business following Distribution 1, no debt will exist between Distributing 1 and Controlled 1 at the time of, or after, Distribution 1. Any indebtedness owed by Controlled 1 to Distributing

1 will not be stock or securities of Controlled 1 under § 355 of the Internal Revenue Code.

(g) Neither Distributing 1 nor Controlled 1 is an investment company as defined in § 368(a)(2)(F)(iii) and (iv).

(h) The five years of financial information submitted on behalf of Distributing 1 for Business B and Business C represents the present operations of each business, and, with regard to each, there have been no substantial operational changes since the date of the last financial statements submitted.

(i) There is no plan or intention to liquidate either Distributing 1 or Controlled 1, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either after Distribution 1, except in the ordinary course of business.

(j) Except for Distribution 2 and Distribution 3 described below, there is no plan or intention by any Distributing 1 shareholder to sell, exchange, transfer by gift, or otherwise dispose of any stock in either Distributing 1 or Controlled 1 after Distribution 1.

(k) Except for purchases and sales of stock under buy-sell agreements and employee stock purchase plans, there is no plan or intention by either Distributing 1 or Controlled 1, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction.

(l) Payments made in all continuing transactions between Distributing 1 and Controlled 1 will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length,

Contribution 1 and Distribution 1 Rulings

Based solely on the information submitted and the representations set forth above, we rule as follows on Contribution 1 and Distribution 1:

(1) Contribution 1, followed by Distribution 1, will be a reorganization under § 368(a)(1)(D). Distributing 1 and Controlled 1 will each be "a party to a reorganization" under § 368(b).

(2) No gain or loss will be recognized by Distributing 1 on Contribution 1 (§§ 361(a) and 357(a); see Rev. Rul. 79-258, 1979-2 C.B. 143).

(3) No gain or loss will be recognized by Controlled 1 on Contribution 1

(§ 1032(a)).

(4) The basis of each Business C asset received by Controlled 1 will equal the basis of that asset in the hands of Distributing 1 immediately before its transfer (§ 362(b)).

(5) The holding period of each Business C asset received by Controlled 1 will include the period during which that asset was held by Distributing 1 (§ 1223(2)).

(6) No gain or loss will be recognized by Distributing 1 on Distribution 1 (§361(c)(1)).

(7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) Distributing 2 on its receipt of Controlled 1 stock in Distribution 1 (§ 355(a)(1)).

(8) The holding period of the Controlled 1 stock received by Distributing 2 will include the holding period of the Distributing 1 stock on which Distribution 1 is made, provided the stock is held as a capital asset on the date of Distribution 1 (§ 1223(1)).

(9) As provided in § 312(h), proper allocation of earnings and profits between Distributing 1 and Controlled 1 will be made under § 1.312-10(a).

Contribution 2 and Distribution 2 Representations

Distributing 2 makes the following representations concerning Distribution 2:

(a) No part of the consideration to be distributed by Distributing 2 will be received by a shareholder as a creditor, employee, or in any capacity other than that of a Distributing 2 shareholder.

(b) Immediately after Distribution 2, at least 90 percent of the fair market value of the gross assets of Controlled 2 will consist of stock and securities of Distributing 1. Distributing 2 and Distributing 1 each will continue the active conduct of its business, independently and with its separate employees.

(c) The total adjusted basis and fair market value of the assets transferred by Distributing 2 to Controlled 2 will, in each instance, equal or exceed the sum of (i) the liabilities assumed by Controlled 2, (ii) any liabilities to which the transferred assets are subject, and (iii) the fair market value of any other property (including money) distributed to Distributing 2 shareholders under the plan of reorganization or to Distributing 2 creditors in connection with the reorganization.

(d) The liabilities assumed by Controlled 2 in the transaction and any liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.

(e) Distribution 2 is being carried out as part of a plan to allow Controlled 2 key employees to acquire a significant direct equity interest in Controlled 2. Distribution 2 is motivated in whole or substantial part by this corporate business purpose.

(f) Except for indebtedness that may arise in the ordinary course of business following Distribution 2, no debt will exist between Distributing 2 and Controlled 2 at the time of, or after, Distribution 2. Any indebtedness owed by Controlled 2 to Distributing 2 after Distribution 2 will not be stock or securities of Controlled 2 under § 355.

(g) Neither Distributing 2 nor Controlled 2 is an investment company as defined in § 368(a)(2)(F)(iii) and (iv).

(h) The five years of financial information submitted on behalf of Distributing 2 for Business A and Controlled 2 for Business B represent each corporation's present operations, and, regarding each corporation, there have been no substantial operational changes since the date of the last financial statements submitted.

(i) There is no plan or intention to liquidate either Distributing 2 or Controlled 2, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either after Distribution 2, except in the ordinary course of business.

(j) Except for purchases and sales of stock under buy-sell agreements and employee stock purchase plans, there is no plan or intention by any Distributing 2 shareholder to sell, exchange, transfer by gift, or otherwise dispose of any stock in either Distributing 2 or Controlled 2 after Distribution 2.

(k) Except for purchases and sales of stock under buy-sell agreements and employee stock purchase plans, there is no plan or intention by either Distributing 2 or Controlled 2, directly or through any subsidiary corporation, to purchase any of its outstanding stock after Distribution 2.

(l) Payments made in all continuing transactions between Distributing 2 and Controlled 2 will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

(m) Immediately before Distribution 2, items of income, gain, loss, deduction, and credit, if any, will be taken into account as required by the applicable intercompany transaction regulations (see § 1.1502-13 and § 1.1502-14 of the Income Tax

Regulations as in effect before the publication of T.D. 8597, 1995-2 C.B. 147, and as currently in effect; § 1.1502-13 as published by T.D. 8597). Any excess loss account Distributing 2 may have in Controlled 2 stock will be included in income immediately before Distribution 2 to the extent required by the applicable regulations (see § 1.1502-19).

(n) Distribution 2 is not part of a "plan or series of related transactions" (within the meaning of § 355(e)) pursuant to which one or more persons will acquire, directly or indirectly, stock possessing 50 percent or more of the total combined voting power of all classes of stock of either Distributing 2 or Controlled 2, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing 2 or Controlled 2.

Contribution 2 and Distribution 2 Rulings

Based solely on the information submitted and the representations set forth above, we rule as follows on Contribution 2 and Distribution 2:

(1) For federal income tax purposes, Distribution 2 will be treated as a distribution by Distributing 2 of its Controlled 2 stock to the Distributing 2 shareholders (see Rev. Rul. 77-191, 1977-1 C.B. 94).

(2) Contribution 2, followed by Distribution 2, will be a reorganization under § 368(a)(1)(D). Distributing 2 and Controlled 2 will each be "a party to a reorganization" under § 368(b).

(3) No gain or loss will be recognized by Distributing 2 on Contribution 2 (§§ 361(a) and 357(a)).

(4) No gain or loss will be recognized by Controlled 2 on Contribution 2 (§ 1032(a)).

(5) The basis of each Business B asset received by Controlled 2 will equal the basis of that asset in the hands of Distributing 2 immediately before its transfer (§ 362(b)).

(6) The holding period of each Business B asset received by Controlled 2 will include the period during which that asset was held by Distributing 2 (§ 1223(2)).

(7) No gain or loss will be recognized by Distributing 2 on Distribution 2 (§361(c)(1)).

(8) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the Distributing 2 shareholders on their receipt of Controlled 2 stock in Distribution 2 (§ 355(a)(1)).

(9) The holding period of the Controlled 2 stock received by Distributing 2 shareholders will include the holding period of the Distributing 2 stock on which Distribution 2 is made, provided the stock is held as a capital asset on the date of Distribution 2 (§ 1223(1)).

(10) As provided in § 312(h), proper allocation of earnings and profits between Distributing 2 and Controlled 2 will be made under § 1.312-10(a).

Distribution 3 Representations

Distributing 2 makes the following representations concerning Distribution 3:

(a) No part of the consideration to be distributed by Distributing 2 will be received by a shareholder as a creditor, employee, or in any capacity other than that of a Distributing 2 shareholder.

(b) Following Distribution 3, Distributing 2 and Controlled 1 each will continue the active conduct of its business, independently and with its separate employees.

(c) Distribution 3 is being carried out as part of a plan to allow Controlled 1 key employees to acquire a significant direct equity interest in Controlled 1. Distribution 3 is motivated in whole or substantial part by this corporate business purpose.

(d) Except for indebtedness that may arise in the ordinary course of business following Distribution 3, no debt will exist between Distributing 2 and Controlled 1 at the time of, or after, Distribution 3. Any indebtedness owed by Controlled 1 to Distributing 2 after Distribution 3 will not be stock or securities of Controlled 1 under § 355.

(e) Neither Distributing 2 nor Controlled 1 is an investment company as defined in § 368(a)(2)(F)(iii) and (iv).

(f) The five years of financial information submitted on behalf of Distributing 2 for Business A and Controlled 1 for Business C represent each corporation's present operations, and, regarding each corporation, there have been no substantial operational changes since the date of the last financial statements submitted.

(g) There is no plan or intention to liquidate either Distributing 2 or Controlled 1, to merge either corporation with any other corporation, or to sell or otherwise dispose

of the assets of either after Distribution 3, except in the ordinary course of business.

(h) Except for purchases and sales of stock under buy-sell agreements and employee stock purchase plans, there is no plan or intention by any Distributing 2 shareholder to sell, exchange, transfer by gift, or otherwise dispose of any stock in either Distributing 2 or Controlled 1 after Distribution 3.

(i) Except for purchases and sales of stock under buy-sell agreements and employee stock purchase plans, there is no plan or intention by either Distributing 2 or Controlled 1, directly or through any subsidiary corporation, to purchase any of its outstanding stock after Distribution 3.

(j) Payments made in all continuing transactions between Distributing 2 and Controlled 1 will be for fair market value based on terms and conditions arrived at by parties bargaining at arm's length.

(k) Immediately before Distribution 3, items of income, gain, loss, deduction, and credit, if any, will be taken into account as required by the applicable intercompany transaction regulations (see § 1.1502-13 and § 1.1502-14 as in effect before the publication of T.D. 8597, 1995-2 C.B. 147, and as currently in effect; § 1.1502-13 as published by T.D. 8597). Any excess loss account Distributing 2 may have in Controlled 1 stock will be included in income immediately before Distribution 3 to the extent required by the applicable regulations (see § 1.1502-19).

(l) Distribution 3 is not part of a "plan or series of related transactions" (within the meaning of § 355(e)) pursuant to which one or more persons will acquire, directly or indirectly, stock possessing 50 percent or more of the total combined voting power of all classes of stock of either Distributing 2 or Controlled 1, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing 2 or Controlled 1.

Distribution 3 Rulings

Based solely on the information submitted and the representations set forth above, we rule as follows on Distribution 3:

(1) For federal income tax purposes, Distribution 3 will be treated as a distribution by Distributing 2 of the Controlled 1 stock to the Distributing 2 shareholders (Rev. Rul. 77-191, 1977-1 C.B. 94).

(2) No gain or loss will be recognized by Distributing 2 on its distribution of the Controlled 1 stock in Distribution 3 (§ 355(c)).

(3) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the Distributing 2 shareholders on their receipt of the Controlled 1 stock in Distribution 3 (§ 355(a)(1)).

(4) The aggregate basis of the Distributing 2, Controlled 1, and Controlled 2 stock in the hands of each Distributing 2 shareholder after Distribution 3 will equal the shareholder's basis in the Distributing 2 stock immediately before Distribution 3, allocated in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§ 358(a) and (b)(2)).

(5) The holding period of the Controlled 1 stock received by each Distributing 2 shareholder will include the holding period of the Distributing 2 stock on which Distribution 3 is made, provided the stock is held as a capital asset on the date of Distribution 3 (§ 1223(1)).

(6) As provided in § 312(h), proper allocation of earnings and profits between Distributing 2 and Controlled 1 will be made under § 1.312-10(b).

General Ruling

The transactions described in this letter will have no adverse effect on any of the Prior Rulings, and each of the Prior Rulings will retain full force and effect.

Caveats

We express no opinion on the tax effects of the transaction under other provisions of the Code and regulations, or the tax effects of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered by the above rulings. In particular, no opinion is given on (a) the redemptions described above in step (vii) or (b) any recapitalization of Distributing 1 that may occur as part of the proposed transaction.

Temporary or final regulations pertaining to one or more issues addressed in this ruling letter (including regulations under § 358(g)) have yet to be adopted. Therefore, this ruling letter may be revoked or modified if adopted temporary or final regulations are inconsistent with any conclusions reached herein. See section 12.04 of Rev. Proc. 98-1, 1998-1 I.R.B. 7, which addresses, in greater detail, when a ruling will be revoked or modified. However, when the criteria in section 12.05 of Rev. Proc. 98-1 are satisfied, a ruling is seldom revoked or modified retroactively, except in rare or unusual circumstances.

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Procedural Statements

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Each taxpayer involved in the transaction should attach a copy of this letter to the taxpayer's federal income tax return for the taxable year in which the transaction is completed.

In accordance with the power of attorney on file in this office, a copy of this letter is being sent to the taxpayer.

Sincerely,

Assistant Chief Counsel (Corporate)

By: 

Wayne T. Murray

Senior Technician/Reviewer

Branch 4